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No. 91-1473

In The

Supreme Court of the United States

October Term, 1991

EDMUND F. SHEEHY, et al.,

Petitioners,

vs.

STATE OF MONTANA
MONTANA DEPARTMENT OF REVENUE,

Respondent.

Petition For A Writ Of Certiorari To The Montana Supreme Court

BRIEF IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether this Court's decision in *Davis v. Michigan Department of Treasury,* 489 U.S. 803 (1989), is the type of case to be applied retroactively under the test established by this Court in *James B. Beam Distilling Co. v. Georgia,* ___ U.S. ___, 111 S.Ct. 2439 (1991).

2. Whether the Petitioners at this stage in the proceedings are able to raise a new issue of law which has not been previously ruled on by the Montana Supreme Court.

3. Whether the Montana Supreme Court correctly applied the test established by this Court in *Chevron v. Huson,* 404 U.S. 97 (1971), holding that the *Davis* decision should not be applied retroactively.

LIST OF PARTIES AND RULE 28-2.1 STATEMENT

The undersigned, counsel of record for Montana Department of Revenue, certifies that the following parties have an interest in the outcome of this case as Respondents:

State of Montana;
Citizens of the State of Montana;
State of Virginia;
State of South Carolina;
State of North Carolina;
State of New York;
State of Arkansas; and
All other states with presently pending litigation of this nature.

The parties having an interest in the outcome of this case as Petitioners are:

Edmund F. Sheehy, et al.; and
Federal retirees living in states which previously exempted state and local retirement benefits from taxation either by statute, state constitution, or both.

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Petition For A Writ Of Certiorari To The Montana Supreme Court

BRIEF IN OPPOSITION

On April 27, 1992, pursuant to Rule 30, Sup. Ct. R., the Clerk of this Court extended the time within which the Respondents had to file this brief in opposition through May 8, 1992.

The Respondent, Department of Revenue of the State of Montana, requests this Court deny the petition for a writ of certiorari to the Montana Supreme Court to review its decision in *Edmund F. Sheehy et al. v. State of Montana, the Department of Revenue,* ___ Mont. ___, 820 P.2d 1257 (1991).

OPINION BELOW

The Montana Department of Revenue concurs in the Petitioners' statement of the opinion below.

JURISDICTION

The Montana Department of Revenue concurs with the Petitioners' reference to jurisdiction.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

This case concerns 4 U.S.C. § 111 and the Supremacy Clause of the Constitution.

STATEMENT OF THE CASE

The Montana Department of Revenue submits the following Statement of the Case due to the failure of the Petitioners to include a statement in their petition pursuant to Rule 14.1(h), Sup. Ct. R. The facts of this case and the description of the proceedings below are adequately and completely set out in the decision of the Montana Supreme Court. *Petitioners' Appendix,* 2a-3a.

REASONS FOR NOT GRANTING THE WRIT OF CERTIORARI

Summary of Argument

Petitioners advance three separate grounds for this Court to grant certiorari in this case. Under the rules of this Court none of the three grounds present a sufficient reason for taking jurisdiction.

In their first argument, Petitioners misread this Court's holding in *James B. Beam Distilling Co. v. Georgia*, ___ U.S. ___, 111 S. Ct. 2439 (1991), arguing that they are entitled to refunds because the taxpayer in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), received a refund. Pursuant to the test established by this Court in *Beam* the issue of retroactivity was reserved in *Davis*, and therefore, *Davis* is not to be applied retroactively. *Beam*, 111 S. Ct. at 2445.

In their second argument, Petitioners argue the Montana Supreme Court violated the United States Constitutional principal of supremacy of law. However, this issue was not argued by the Petitioners either before the trial court or the Montana Supreme Court. Therefore, under this Court's holding in *Exxon Corp. v. Eagerton*, 103 S. Ct. 2296, 462 U.S. 176, 761 L.Ed.2d 497 (1983), it does not have jurisdiction to consider such an issue.

In their third argument, Petitioners argue the Montana Supreme Court incorrectly applied the test established by this Court to determine whether a prior decision should be applied retroactively. The Montana Supreme Court using the *Chevron v. Huson*, 404 U.S. 97 (1971) test correctly held that the *Davis* decision was not clearly foreshadowed by prior precedent. *Petitioners'*

Appendix, 7a-13a. Further, the Montana Court held that the doctrine of inter-governmental immunity would not be furthered or retarded by the retroactive application of the *Davis* decision. *Petitioners' Appendix*, 13a. Lastly, the Court held it would place an inequitable burden on all the taxpayers of Montana to make refunds to the Petitioners. *Petitioners' Appendix*, 13a-14a.

I. Introduction

This petition essentially presents three arguments or grounds for this Court to grant certiorari. Under the terms of Rule 10, Sup. Ct. R., the granting of certiorari is a discretionary act and will only be granted "when there are special and important reasons therefor." None of the arguments advanced by the Petitioners present sufficiently compelling reasons rising to the level of importance necessary for this Court to exercise its discretion.

First, Petitioners erroneously claim that under the plain meaning of this Court's decision in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), Petitioners are entitled to refunds of taxes previously collected. Under the terms of the test established in *James B. Beam Distilling Co. v. Georgia*, ___ U.S. ___, 111 S. Ct. 2439 (1991), *Davis* is not the type of decision which was required to be applied retroactively.

Secondly, Petitioners resurrect the nineteenth century spectre of nullification to assert the Montana Supreme Court's decision in *Sheehy, et al. v. State of Montana, Department of Revenue*, ___ Mont. ___, 820 P.2d 1257 (1991), suspends the effective date of a federal statute. As shown by the *Sheehy* decision this issue was not raised in

the court below. Therefore, this issue may not be raised in this Court as grounds for granting certiorari.

Lastly, Petitioners assert the Montana Supreme Court incorrectly applied the test established by this Court in *Chevron v. Huson*, 404 U.S. 97 (1971). This Court's discretionary jurisdiction will not extend to correct the errors of lower courts.

II. Under the Court's Holding in *Beam v. Georgia*, supra, the *Davis* Decision is Not to be Applied Retroactively

Petitioners present their first argument in what may be considered as the preamble to their argument. They argue the decision of the Montana Supreme Court, "is contrary to the plain holding of this Court in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989)". Clearly, Petitioners have misread the *Davis* decision. Since Davis was accorded, "the benefit of the decision in *Davis*," Petitioners assert, "it necessarily follows that the holding must be applied 'to all others not barred by procedural requirements or res judicata.' " *Petitioners' Brief*, page 3. In support of that assertion Petitioners rely upon this Court's decision in *James B. Beam Distilling Co. v. Georgia*, ___ U.S. ___, 111 S. Ct. 2439 (1991). *Ibid.*

In *Beam* this Court was faced with essentially the same situation as presented by this case. Beam Distilling Company was seeking refunds of Georgia's tax on alcoholic beverages. Beam's refund claim was based on this Court's decision in *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984). The Supreme Court of Georgia applying the

Chevron test held *Bacchus* should not be applied retroactively, and therefore, denied Beam's refund claim. Beam then sought relief in this Court. *Beam*, 111 S. Ct. at 2441.

This Court in *Beam* established the test for determining in choice of law cases whether a prior decision is to be applied retroactively. Justice Souter writing the plurality opinion held that a prior decision is to be applied retroactively if the Court, "did not reserve the question whether its holding should be applied to the parties before it, . . . ". *Beam*, 111 S. Ct. at 2445. Thus, the question becomes whether this Court in *Davis* reserved the question of retroactivity. Clearly, based on this Court's discussion in *Davis* of the appropriate remedy, the choice of law question was reserved. *Davis*, 489 U.S. at 817-818. This Court's lack of direction to the Michigan Supreme Court in the *Davis* remand order further demonstrates the question that retroactivity was reserved. This Court acknowledged that Michigan conceded that refunds would be made to Mr. Davis of taxes collected.

> The State having conceded that a refund is appropriate in these circumstances, . . . to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund.

Davis, 489 U.S. at 817. However, this Court specifically reserved the issue whether its decision should apply to any other taxpayers. This Court held it was not the appropriate forum to settle such questions.

> We have recognized, in cases involving invalid classifications in the distribution of government benefits, that the appropriate remedy "is a mandate of equal treatment, a result that can be accomplished by withdrawal of benefits from

> the favored class as well as by extension of benefits to the excluded class." *Heckler v. Mathews*, 465 U.S. 728, 740 (1984). See *Iowa-Des Moines Bank, supra*, at 247; see also *Welch v. United States*, 398 U.S. 333, 361 (1970) (Harlan, J. concurring in judgment).
>
> In this case, appellant's claim could be resolved either by extending the tax exemption to retired federal employees (or to all retired employees), or by eliminating the exemption for retired state and local government employees. . . .

Davis, 489 U.S. at 817-818. The *Davis* case was then "remanded for proceedings not inconsistent with this opinion." *Davis*, 489 U.S. at 818.

Therefore, since the question of retroactivity was reserved, it is a question which must be resolved in the state court forum. This conclusion is consistent with this Court's opinion in *Beam*. Again, Justice Souter writing in *Beam* states that the retroactivity issue in *Bacchus* was not reserved because the Court ordered the state court to consider the "pass-through defense". *Beam*, 111 S. Ct. at 2445. In contrast to the *Bacchus* remand order, this Court in *Davis* did not direct the Michigan Court to take any specific action.

> Because the Court in *Bacchus* remanded the case solely for consideration of the pass-through defense, it thus should be read as having retroactively applied the rule there decided. . . .

Beam, id. Therefore, applying this Court's ruling in *Beam* to the *Davis* case it is evident the issue of retroactivity was reserved. Therefore, it was not error for the Montana Supreme Court in *Sheehy* to apply the *Chevron* test and

refuse to order refunds to the Petitioners. Further, because the issue of retroactivity in *Davis* was reserved the *Sheehy* case has not been decided in a way which conflicts with the applicable decisions of this Court. Accordingly, under Rule 10.1(c) this is not a proper case for this Court to grant certiorari.

III. The Montana Supreme Court has Not by Its Decision in *Sheehy* made 4 U.S.C. § 111 Applicable Only to Tax Years After 1988

In their second argument, the Petitioners by the use of sophistry, raise the nineteenth century spectre of nullification. Petitioners assert the Montana Supreme Court's decision impedes and retards the operation of 4 U.S.C. § 111. Further, they assert that based upon the *Sheehy* decision, states will decide when and if they will comply with federal law. *Petitioners' Petition*, page 5. This issue was not raised in either the District Court or on appeal to the Montana Supreme Court. The Montana Supreme Court's opinion shows the only issue presented was the question whether the *Davis* decision must be applied retroactively entitling the Petitioners to refunds. *Petitioners' Appendix*, 2a. Pursuant to Rule 10, Sup. Ct. R., this Court will only consider substantial federal issues on certiorari. Consistent with that rule this Court has no jurisdiction to consider a contention where it does not affirmatively appear that the issue was considered and decided in the state courts. *Exxon Corp. v. Eagerton*, 103 S. Ct. 2296, 462 U.S. 176, 76 L.Ed.2d 497 (1983). Therefore, this Court should not grant certiorari on this issue.

IV. The Montana Supreme Court's Application of the *Chevron* Test to This Case Was Not in Error and *Davis* Should Not be Applied Retroactively

Petitioners last grounds for seeking certiorari is that the Montana Supreme Court misapplied the *Chevron* test in deciding this case. Under the plain meaning of Rule 10, Sup. Ct. R., this Court will only grant certiorari in cases presenting substantial federal questions. Petitions seeking to have this Court correct the errors of lower courts generally do not present substantial federal issues. The exercise of this Court's discretionary jurisdiction does not extend to correct the errors of lower courts. Leahy, Edward R., *The Ten Commandments of Certiorari,* 71 ABA Journal 78 (October, 1985).

This same issue was raised in the Petition For A Writ of Certiorari in *Bass, et al., v. State of South Carolina, et al.,* No. 90-673. In that case, the Petitioners asserted the South Carolina Supreme Court's application of *Davis* was in error inasmuch as it did not correctly apply the *Chevron* test. The only difference between the positions of South Carolina and Montana is the facts – principally the third factor of the *Chevron* test. The third part of the Chevron test requires a court to consider the equities of the situation. As shown by the argument of South Carolina, the impact on it is approximately $200,000,000. *Respondent's Appendix,* page 5a. The impact on Montana with a considerably smaller population of both federal retirees and ordinary citizens is proportionately less. However on this point, the Montana Supreme Court, just as the South Carolina Supreme Court, held it would be inequitable to impose the burden of making refunds on all taxpayers.

Petitioners' Appendix, page 14a; *Respondent's Appendix,* page 6a.

Since the argument of the Petitioners in this case and the argument of the Petitioners in the *Bass* case are identical the Montana Department of Revenue adopts by reference and incorporates in this brief the argument of the State of South Carolina on this point. South Carolina's argument is set out in full in the Respondent's Appendix to this brief. The issue of whether the state courts correctly applied the *Chevron* test is the only issue in common between the *Bass* case and this case.

CONCLUSION

The petition should be denied because:

(a) there is no conflict between the Montana Supreme Court's decision in *Sheehy* and this Court's decision in *Beam;*

(b) the Petitioners' nullification argument is not properly before this Court; and,

(c) the Montana Supreme Court's prospective application of the *Davis* decision was correct.

Respectfully submitted,

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APPENDIX

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Excerpts from the Respondents' Brief in Opposition to Petition for a Writ of Certiorari *Francis Edwin Bass, Jr., et al. v. State of South Carolina, et al.*, No. 90-673, Supreme Court of the United States October Term 1990 ..... 1a

The Montana Department of Revenue hereby incorporates by reference the following text found in the Respondents' Brief in Opposition to Petition for a Writ of Certiorari, *Francis Edwin Bass, et al. v. State of South Carolina, et al.*; No. 90-673, October Term 1990. The text begins on page 7 of the brief filed by the State of South Carolina and states as follows:

ARGUMENT III

THE PETITION SHOULD BE DENIED BECAUSE THE SOUTH CAROLINA SUPREME COURT'S PROSPECTIVE APPLICATION OF *DAVIS* WAS A CORRECT AND PROPER APPLICATION UNDER *CHEVRON OIL CO. V. HUDSON*, SUPRA.

In *Chevron*, this Court established a three prong test to determine when its decisions would have prospective application. Each of the three factors is here satisfied.

The First Factor

The South Carolina Supreme Court found, "The *Davis* decision for the first time, held that the doctrine of intergovernmental tax immunity applied to retirement income of a federal employee". *Davis* established a new principle of law and was a case of first impression. Further, it is illogical to argue that *Davis* was a restatement of law that was clearly foreshadowed because of the decisions in *McCulloch v. Maryland*, 4 Wheat 316 [4 L.Ed. 579] (1819); *Helvering v. Gerhardt*, 304 U.S. 405, 58 S.Ct. 969, 82 L.Ed. 1427 (1938) or *Graves v. New York, ex rel O'Keefe*, 306 U.S.

466, 59 S.Ct. 595, 83 L.Ed. 927 (1939).[1] The genesis of the *Davis* holding was not there founded nor was it stated in *Zucker v. United States*, 758 F.2d 637, cert. denied 474 U.S. 842, 106 S.Ct. 129, 88 L.Ed.2d 105 (1985), *Kizas v. Webster*, 227 U.S. App. D.C. 327, 707 F.2d 524 (1983) cert. denied 464 U.S. 1042, 104 S.Ct. 709, 79 L.Ed.2d 173 (1984) or *Clark v. United States*, 691 F.2d 837 (CA7, 1982). None of these cases dealt with the issue of the state taxation of the income of a retired federal employee. In *Zucker v. United States*, supra., the issue involved cost of living increases and whether Congress could amend or modify existing law so as to reduce the increases. In commenting on the question of whether retirement income was deferred compensation, the Court by dictum stated:

> "The legislative history lends some support to the view that the basic annuity was intended as deferred compensation . . . " p. 639.

The Court, on page 639, also stated:

> "This Court does not reach the question of the compensatory nature of the basic annuity to which the retiree became entitled upon retirement . . . " p. 639.

The Court did say in *Zucker* that there was case law that could be construed to support a concept of deferred compensation (p. 639) and cited *Steinberg v. United States*, 163 F.Supp. 590, 143 Ct.Cl. 1 (1958) as its authority. It is

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[1] *McCulloch* held that the State could not tax property of the federal government. *Helvering* and *Graves* treated the taxation of income of employees of the federal and state governments. Taxation of the income of federal retirees was not there considered.

respectfully submitted that the language in *Steinberg* is somewhat conflicting. The Court held:

> "The right of a Federal employee to an annuity is not born of a contractual relationship between the government and the employee, but is more in the nature of a gratuity granted in appreciation for long and faithful service . . . Although an annuity is paid for past, as distinguished from present services, the legal relationship between the parties is in all material respects parallel . . . "

Steinberg concerned the issue of whether Congress could deny the annuity to a person who refused to testify before a grand jury. It did not treat Section 4 U.S.C. 111 or the doctrine of intergovern-mental tax immunity.[2]

The second case of *Kizas v. Webster*, supra, related to the Federal Bureau of Investigation's modifications of a policy for appointment to the position of Special Agent. The issue was whether employees had vested property rights under the policy. That decision did not treat the question that is here involved.

The case of *Clark v. United States*, supra, concerned allegations of discrimination because federal retirees received a cost of living adjustment while none was provided to state and private pensioners. It was alleged that this denied equal protection and due process. The Court held otherwise and found no discrimination. Again, we respectfully submit that the Court did not there address

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[2] A gratuity is a gift and not payment for services rendered. Retirement income cannot be both a gratuity and deferred compensation.

the issue of whether 4 U.S.C. 111 applied to retirement benefits.

By reason of the above, there was no reasonable basis on which the respondents could have reasonably contemplated that its taxing statutes abridged the provisions of 4 U.S.C. 111.

The *Davis* decision was thus not clearly foreshadowed.[3] Surely under the facts as here exist, the respondents are not to be held to an exact standard of interpreting existing law when the statute does not upon its face clearly apply to the factual matter involved. Frequently, there are different views and interpretations of the language of statutes when the statutes do not by clear language address the specific issue.[4] There was no clear rule of law prior to *Davis* and hence *Davis* could not have been "clearly foreshadowed." The first prong of *Chevron* was thus satisfied.

The Second Factor

The state promptly eliminated the discriminatory taxation by taxing the retirement income of retired state employees in like manner as the retirement income of federal retirees.

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[3] In South Carolina, this tax had been voluntarily paid since 1945, a period of almost 45 years. Neither the retirees in South Carolina nor the State knew or suspected the taxation to be unlawful.

[4] It should be noted that three different courts in Michigan and His Honor Justice Stevens of this Honorable Court held that the Michigan statute did not offend 4 U.S.C. 111.

The prior history in South Carolina was the voluntary payment of the tax for almost 45 years. The tax so collected was appropriated each year for the benefit of all of the state's citizens, including the federal retirees. A prospective application of *Davis* can in no way retard its operation. A retrospective application of *Davis* will not further the holding that discrimination in the taxation of retirement income is prohibited. In this case, it would primarily serve to punish the majority of the state's taxpayers by requiring them to fund repayment of taxes that were in good faith and voluntarily paid. The second prong is satisfied.

The Third Factor

The language of the South Carolina Supreme Court correctly addresses this factor. The Court held:

> " . . . If Davis is applied retroactively, the State faces liability for approximately $200,000,000.00 in refunds for taxes it collected in good faith under an unchallenged and presumptively valid statute. South Carolina would have to refund this sum for taxes already received which it has already spent for public purposes; many of these benefits have already been received by federal retirees residing in South Carolina. The refund of such an exorbitant amount would impose a severe financial burden on the State and its citizens as well as endanger the financial integrity of the State."[5]

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[5] An action to recover a tax is an action at law nonetheless the same is governed by equitable principles. *Stone v. White*, 57 S.Ct. 851, 301 U.S. 532, 81 L.Ed. 1265 (1937).

The record reflects that approximately 62,000 retired federal civil service annuitants and retired military persons filed tax returns with the state. It further reflects that approximately two hundred million ($200,000,000) dollars is involved in the action. The federal retirees represent just under 2% of the state's population.[6]

The refund claims approximate 5.95% of the state's appropriated general funds for the 1988-89 fiscal year.[7] It would be inequitable to apply *Davis* retrospectively and to require the refund of this large sum that was voluntarily paid at the expense of the vast majority of the state's population. If the refunds are at issue, it is obvious that the current level of services provided to all the state citizens, including the retirees, would of necessity have to be reduced or added taxes levied. In these claims, it is not Mr. Davis, the person initially contesting the tax, who prosecutes this action. Instead, the claimants are those persons who for a long period of time voluntarily paid the tax and received whatever benefits flowed from the tax payments in the form of public expenditures for public purposes. Those persons seek the refund of the tax at the expense of the State Treasury, which obviously is funded by the state's taxpayers. This inequitable result to all the state's taxpayers is avoided by the prospective application of the *Davis* decision.

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[6] The 1980 census listed the State's population at $3,121,820 [sic].

[7] The State's appropriated general funds for the 1989-90 fiscal year were $3,363,385,451. Act 189, Acts of 1989, Section 127, Recapitulation.

The reasoning of the Court in prospectively applying the decision in *Arizona Governing Committee, etc. v. Norris*, 463 U.S. 1073, 103 S.Ct. 3492, 77 L.Ed.2d 1236 (1983), is equally applicable to this case. The Court there held that the retirement program of the State of Arizona discriminated against female retirees. Retrospective application of the decision, however, was denied because of the adverse results such an application would create. In other words, the adverse effect to the state and its taxpayers outweighed any disadvantage to the retirees. This would be the circumstance in South Carolina should the *Davis* decision be retrospectively applied and the State be required to refund the two hundred million ($200,000,000) dollars.

The equity here involved warrants prospective application and the third prong is thus met.